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The Influence of Political Connections and Foreign Ownership on Tax Avoidance with Corporate Governance as a Moderating Variable

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Abstract: This study aims to analyze the influence of political connections and foreign ownership on tax avoidance, with corporate governance as a moderating variable. The research adopts a quantitative design, focusing on manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023. The sample was selected using purposive sampling, resulting in 36 companies that met the criteria. With three years of observation, a total of 108 financial reports were analyzed. Data collection was conducted through documentation studies, and the analysis employed Moderated Regression Analysis using panel data. The findings of the study indicate that both political connections and foreign ownership have a significant positive effect on tax avoidance. However, corporate governance does not moderate the relationship between these variables and tax avoidance. These results highlight the importance for manufacturing companies to establish more effective oversight and monitoring mechanisms to minimize tax avoidance practices.

Keyword: Tax Avoidance, Political Connections, Foreign Ownership, Corporate Governance

INTRODUCTION

Indonesia, as a developing country, has several sources of revenue in its State Budget. One of the largest sources of state revenue comes from the taxation sector. The success of a country's development is largely determined by its national income, which in turn can be influenced by the country's strategic geographic position. The more strategically located a country is, the more likely it is to attract increased investment, which can enhance state revenue through the taxation sector (Putu & Hasibuan, 2022).

Tax is a mandatory contribution paid by taxpayers to the state, which is coercive in nature in accordance with the law, without direct reciprocal benefits, and is used for the benefit of the country. The amount of tax payment is taken from the company's profits at a certain percentage, which sometimes makes companies reluctant to part with a portion of their profits for tax payments. As a result, companies may become aggressive in their tax strategies. Tax avoidance is closely related to the level of profits earned by a company (Hanif et al., 2023). It is a compelling issue, especially with the emergence of corporate tax cases and the fiscal authorities' expectations to increase tax revenue (Manihuruk & Novita, 2022).

One of the most famous tax avoidance cases was carried out by Apple. Apple engaged in tax avoidance in Australia, where all of its sales revenue was redirected to Ireland. As a result of this action, Apple only paid 0.7% of the tax that it should have paid. Another case involved PT Japfa Comfeed Indonesia Tbk in 2020, which experienced a dispute over the correction of the 20% Article 26 Income Tax rate on interest payments, with a dispute value of IDR 16,178,579,069. This occurred due to a disagreement over who the actual beneficial owner of the disputed amount was. In this case, the beneficial owner was not Comfeed Trading BV, but PT Japfa Comfeed Indonesia Tbk. Therefore, the unpaid tax must be paid by the company according to the correct calculation.

PT Indofood Sukses Makmur Tbk was suspected of tax avoidance worth IDR 1.3 billion in 2018 by transferring assets, liabilities, and operations to its subsidiary, PT Indofood CBP Sukses Makmur Tbk. PT Toyota Manufacturing Indonesia was also suspected of tax avoidance in 2013 through transfer pricing to a related party in Singapore. The Tax Justice Network reported in 2019 that PT Bentoel Internasional Investama Tbk, a subsidiary of British American Tobacco, was involved in suspected tax avoidance practices. The manufacturing sector plays a crucial role in supporting national economic growth. However, over the past decade, the contribution of the manufacturing industry has continued to decline from an average of around 20.5 percent of GDP annually, it has shrunk to 18.57 percent. Despite being a major driver of the national economy, the industrial sector continues to face a series of challenges that have reduced its contribution to the economy over the last ten years.

According to a report by the Tax Justice Network, Indonesia is estimated to lose approximately US$4.86 billion per year, equivalent to IDR 68.7 trillion, due to tax avoidance. In a publication titled The State of Tax Justice 2020: Tax Justice in the Time of Covid-19, Tax Justice News reported that of the IDR 68.7 trillion total, the loss was primarily caused by corporate taxpayers engaging in tax avoidance in Indonesia. Losses from corporations amounted to US$4.78 billion or IDR 67.6 trillion, while the remainder came from individual taxpayers, totaling US$78.83 million or IDR 1.1 trillion. Additionally, multinational companies have been shifting profits to so-called tax haven countries to avoid reporting the actual profits earned in the countries where they operate. As a result, such companies end up paying less tax than they should.

Political connections owned by companies can protect them from the risk of being detected when engaging in aggressive tax practices or tax avoidance (Kim & Zhang, 2015). Companies with political ties are often given special treatment or privileges by the government, especially in unique environments like Indonesia. A company is considered to have political connections when a key executive is a member of the government or has close ties with high-ranking government officials. Supported by strong government connections, politically connected companies find it easier to conduct transactions with related parties for various purposes (Hadiyarroyyan, 2022).

The phenomenon related to political connections includes the case of 39 officials from the Ministry of Finance holding dual positions as commissioners in state-owned enterprises, which is considered a violation of regulations and the principle of compliance. The state, through SOEs, cumulatively pays these officials a total of IDR 180 billion per year for their roles as commissioners. The Advocacy and Campaign Team of the National Secretariat of Fitra argues that there is no urgency in appointing government officials as commissioners. Previous research conducted by (Darmawansyah, 2019) found that political connections have a positive and significant effect on tax avoidance. Similarly, (Aynda, 2020) also demonstrated that political connections influence tax avoidance. (Manihuruk & Novita, 2022) found a similar effect in their study. However, different results were reported by (Apriliani & Wulandari, 2023), who found that political connections do not influence tax avoidance. Likewise, (Priady, 2020) found no significant effect of political connections on tax avoidance, and Lusiana et al. (2023) also concluded that political connections have no impact on tax avoidance.

H_1: Political connections have a significant positive effect on tax avoidance

Foreign ownership in companies operating in Indonesia also has the potential to contribute to tax avoidance practices, one of which is through profit shifting (Hadiyarroyyan, 2022). Foreign ownership refers to the proportion of a company's common shares owned by individuals, legal entities, governments, or their subdivisions that are based abroad (Muhajirin et al., 2021). Companies with foreign ownership structures often conduct business extensively across multiple countries. As a result, having commissioners who understand global business activities is crucial these are often foreign nationals. Although foreign-owned companies tend to implement good corporate governance, it cannot be denied that foreign investors are also driven by the goal of maximizing profit, including minimizing the amount of tax paid.

A relevant example of this is PT. Toyota Motor Manufacturing Indonesia (TMMIN), a subsidiary of Toyota Motor Corporation. The majority of TMMIN shares 95 percent are owned by Toyota Motor Corporation, while the remaining 5 percent are held by Astra International. TMMIN engages in transactions with affiliated companies both domestically and internationally. The method is relatively simple: shifting more of the profit burden from one country to another with lower tax rates. TMMIN avoids tax by first selling its products to Toyota Motor Asia Pacific Ltd in Singapore before reselling them to the Philippines and Thailand, as Singapore offers lower income tax rates and even tax exemptions for certain taxpayers.

Research by (Muhajirin et al., 2021) found that foreign ownership has a positive and significant effect on tax avoidance. Similarly, (Annisa & Ratnawati, 2020) reported that foreign ownership influences tax avoidance. (Hadiyarroyyan, 2022) also concluded that foreign ownership has a significant positive effect on tax avoidance. However, a study by (Siti Maisaroh & Setiawan, 2021) found that foreign ownership negatively affects tax avoidance. Meanwhile, research by Astuti et al. (2023) showed that foreign ownership does not affect tax avoidance.

H_2: Foreign ownership has a significant positive effect on tax avoidance.

A good company is one that applies effective corporate governance a system that regulates the roles and relationships between the board of commissioners, directors, shareholders, and other stakeholders, involving a transparent process in determining the company's objectives, achievements, and performance evaluation (Anita et al., 2020). The structure of corporate governance influences how a company fulfills its tax obligations. The board of commissioners plays a key role in corporate governance, tasked with overseeing the policies of the directors and providing them with guidance. The presence of a board of commissioners is expected to ensure that the company operates in accordance with applicable regulations, thereby helping to prevent tax avoidance practices.

In a company, there are usually independent commissioners who come from outside or independent parties who play an important role in overseeing the company. Independent commissioners are those who are members of the board of commissioners, coming from outside the company, do not own shares either directly or indirectly in the company, do not have any affiliation with the company, commissioners, directors, or shareholders, and do not have any business relationships, either directly or indirectly, related to the company's business activities (Aynda, 2020).

Previous research by (Sihono & Febyansyah, 2023) found that the better a company's corporate governance structure, the higher the level of managerial oversight and control, which in turn reduces the impact of tax avoidance on future tax risks. (Priady, 2020) found that institutional ownership moderates the relationship between political connections and tax avoidance, showing no significant effect, and that managerial ownership also does not significantly moderate this relationship. Meanwhile, (Natalina, 2023) found that tax avoidance is not influenced by independent commissioners.

H_3: Corporate governance weakens the positive effect of political connections on tax avoidance

H_4: Corporate governance weakens the positive effect of foreign ownership on tax avoidance

Previous studies have extensively examined the individual relationships between political connections and foreign ownership on tax avoidance. However, no research has yet elaborated on the combined influence of both variables on tax avoidance. This study integrates political connections and foreign ownership in their influence on tax avoidance, with the addition of corporate governance as a moderating variable. The data analysis in this study will be conducted using the STATA application, which is still relatively uncommon in research related to tax avoidance.

Tax avoidance is closely related to tax compliance by taxpayers, in this case, manufacturing companies. The manufacturing sector is chosen for this study due to the high number of tax avoidance cases within it, making it crucial to analyze the factors contributing to such behavior. The combination of political connections and foreign ownership is linked to agency theory, where the owners act as principals and management acts as agents responsible for running the company's operations. The inclusion of corporate governance aims to explain the role of sound corporate governance in minimizing the impact of foreign ownership and political affiliations on tax avoidance practices.

Based on the background described above, the research problem can be formulated as follows: Do political connections and foreign ownership have a positive effect on tax avoidance, and does corporate governance weaken the effect of political connections and foreign ownership on tax avoidance? In line with these research questions, the objective of this study is to analyze the influence of political connections and foreign ownership on tax avoidance, as well as the moderating role of corporate governance in this relationship, focusing on manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023.

METHOD

This study employs a quantitative approach with an associative design, aiming to explain the causal relationship between political connections and foreign ownership on tax avoidance, with corporate governance as a moderating variable. The population in this study consists of all manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023, totaling 171 companies. The sample was selected using purposive sampling, resulting in 36 companies that met the criteria. With three years of observation, a total of 108 company financial reports were obtained as the research sample. Data was collected through documentation by analyzing company financial statements in accordance with the required data for tabulation. Data analysis was conducted using Moderated Regression Analysis (MRA) with the assistance of the STATA software.

RESULTS AND DISCUSSION

Before proceeding to the hypothesis testing stage, it is necessary to first conduct descriptive statistical analysis to examine the data by describing the collected data. The results of the descriptive statistical test are presented as follows.

Table 1. Descriptive statistics test results

	Obs	Mean	Std. Dev	Min	Max
Political connections	108	0,309	0,141	0,143	0,667
Foreign ownership	108	0,313	0,289	0,001	0,982
Corporate governance	108	0,359	0,123	0,125	0,750

Tax Avoidance	108	0,229	0,047	0,111	0,394
Company size	108	28,651	2,841	14,967	33,731

Source: Data is processed (2025)

Based on the data in Table 1, it is shown that the political connection variable has a minimum value of 0.143 and a maximum value of 0.667, with a mean of 0.309 and a standard deviation of 0.141. The mean is closer to the minimum value, indicating that political connections among most manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2021 to 2023 tend to be low. The foreign ownership variable has a minimum value of 0.001 and a maximum value of 0.982, with a mean of 0.313 and a standard deviation of 0.289. The mean being closer to the minimum value indicates that foreign ownership in most manufacturing companies listed on the IDX from 2021 to 2023 also tends to be low.

The corporate governance variable has a minimum value of 0.125 and a maximum value of 0.750, with a mean of 0.359 and a standard deviation of 0.123. The mean being closer to the minimum suggests that corporate governance practices in most manufacturing companies listed on the IDX from 2021 to 2023 are relatively weak. The tax avoidance variable has a minimum value of 0.111 and a maximum value of 0.394, with a mean of 0.229 and a standard deviation of 0.047. The mean being closer to the maximum indicates that tax avoidance practices in most manufacturing companies listed on the IDX from 2021 to 2023 tend to be high. The firm size variable has a minimum value of 14.967 and a maximum value of 33.731, with a mean of 28.651 and a standard deviation of 2.841. The mean being closer to the maximum value indicates that most manufacturing companies listed on the IDX from 2021 to 2023 tend to be large in size.

Next, a model feasibility test was conducted using several tests, including the Chow test and the Lagrange Multiplier test. The results of the model feasibility testing are summarized in Table 2.

Table 2. Model feasibility test results

Test	Criteria	Results	Selected model
Chow test	Prob Cross Section > 0,05 (CEM) Prob Cross Section < 0,05 (FEM)	Prob Cross Section 0,1085 > 0,05	Common Effect Model
Lagrange Multipier test	Prob chi2 < 0,05 (REM) Prob chi2 > 0,05 (CEM)	Prob chi2 0,2222 > 0,05	Common Efect Model

Source: Data is processed (2025)

Referring to the results of the mode feasibility test, it is known that the successfully selected model is the Common Effect Model (CEM). Furthermore, the results of conducting the Common Effect Model regression model test are successfully summarized in Table 3.

Table 3. Direct influence regression model

TA	Coef.	Std. Err	t	P>|t|	[95% Conf. Interval]	
KP	0,377	0,133	2,82	0,004	0,009	0,039
KA	0,243	0,116	2,09	0,037	0,005	0,014
GG	-0,331	0,139	-2,38	0,017	-0,006	0,093
UP	0,286	0,102	2,81	0,006	0,001	0,008
cons	0,313	0,149	2,09	0,039	0,005	0,203

Source: Data is processed (2025)

$$TA = 0,377KP + 0,243KA - 0,331GG + 0,286UP + e \quad \ldots(1)$$

The coefficient value for the political connection variable is 0.377, indicating that for every one-unit increase in political connection, tax avoidance increases by 37.7 percent, assuming other variables remain constant. The hypothesis test for the first hypothesis (H1) resulted in a probability value of 0.004 < 0.05. This means that political connections have a significant effect on tax avoidance, and thus **Hypothesis 1 is accepted.**

The coefficient value for the foreign ownership variable is 0.243, indicating that for every one-unit increase in foreign ownership, tax avoidance increases by 24.3 percent, assuming other variables remain constant. The hypothesis test for the second hypothesis (H2) yielded a probability value of 0.037 < 0.05. This indicates that foreign ownership has a significant effect on tax avoidance, and therefore **Hypothesis 2 is accepted.**

The interaction/moderation effect test aims to determine whether the moderating variable can strengthen or weaken the relationship between the independent variables and the dependent variable. The results of the regression model test after including the moderating variable are presented as follows.

Table 4. Moderation regression model

TA	Coef.	Std. Err	t	P>|t|	[95% Conf. Interval]	
KP.GG	-0,037	0,071	-0,52	0,603	-0,178	0,104
KA.GG	-0,008	0,037	-0,23	0,821	-0,083	0,066
Cons	0,234	0,009	26,13	0,000	0,216	0,252

Source: Data is processed (2025)

$$TA = -0,037\ KP.GG - 0,008\ KA.GG + e \ldots (2)$$

The coefficient value for political connection after including the corporate governance variable is -0.037, indicating that for every one-unit increase in political connection, tax avoidance decreases by 3.7 percent indirectly through corporate governance, assuming other variables remain constant. The hypothesis test for the third hypothesis (H3) yielded a probability value of 0.603 > 0.05, which means that corporate governance does not moderate the relationship between political connection and tax avoidance. Therefore, **Hypothesis 3 is rejected.**

The coefficient value for foreign ownership after including the corporate governance variable is -0.008, indicating that for every one-unit increase in foreign ownership, tax avoidance decreases by 0.8 percent indirectly through corporate governance, assuming other variables remain constant. The hypothesis test for the fourth hypothesis (H4) resulted in a probability value of 0.821 > 0.05, which means that corporate governance does not moderate the relationship between foreign ownership and tax avoidance. Thus, **Hypothesis 4 is rejected.**

Agency theory explains the relationship between the principal and the agent. In a company, the principal is the owner, while the agent is the management that runs the company. The relationship between agency theory and taxation lies in the fact that if management has an interest in manipulating company profits, it can reduce the company's tax burden (Sriyono & Andesto, 2022). Companies with concentrated ownership controlled by a few parties are more likely to experience conflicts of interest between controlling shareholders and management on one side, and non-controlling shareholders on the other. Moreover, the relatively low potential for tax audits is one of the advantages enjoyed by politically connected companies, which may embolden them to engage in tax planning or avoidance, leading to a lack of transparency in financial reporting. Politically connected companies do not always engage in tax avoidance through their connections, but they can utilize these connections to facilitate tax avoidance (Lusiana et al., 2023).

Stakeholder theory explains how companies can be held accountable to their broader environment by implementing good corporate governance. Through strong governance, tax avoidance practices can be minimized due to adequate oversight by independent commissioners, who are not influenced by interests other than those of the company. In theory, effective corporate governance can help reduce tax avoidance practices because independent commissioners play a crucial role in providing oversight and ensuring the company complies with regulations.

However, in practice particularly among the manufacturing companies included as samples in this study corporate governance is relatively weak. This is evidenced by the descriptive statistics results, which show that the average value is closer to the minimum, indicating that most manufacturing companies have few independent commissioners who can effectively monitor and help minimize tax avoidance practices. As a result, corporate governance proxied by the proportion of independent commissioners fails to moderate or weaken the impact of political connections on tax avoidance. Corporate governance is reflected in the higher proportion of independent commissioners relative to the total number of commissioners. The board of commissioners is not only accountable to shareholders but also to the broader public (Simorangkir et al., 2018). Independent commissioners play a vital role in guiding and ensuring that the company complies with applicable regulations (Hidayat & Muliasari, 2020).

CONCLUSION

The results of this study indicate that political connections and foreign ownership individually influence tax avoidance in a positive direction, meaning that the higher the level of political connection or foreign ownership, the higher the level of tax avoidance. Another finding also reveals that corporate governance, proxied by the proportion of the board of commissioners, is not able to weaken the influence of either variable on tax avoidance in manufacturing companies.

This study is limited to examining the effect of political connections and foreign ownership on tax avoidance with corporate governance as a moderating variable. The research was conducted only on manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2021–2023 period, so the findings cannot be generalized to different time periods or other sectors. Corporate governance was measured using the composition of the board of commissioners, specifically by comparing the number of independent commissioners to the total number of commissioners.

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